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UNCLAS SECTION 01 OF 10 CARACAS 000173

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E.O. 12958: N/A
TAGS: ECON EINV EFIN KTDB STR OPIC VE
SUBJECT: VENEZUELA -- INVESTMENT CLIMATE STATEMENT (PART 1/2)

REF: 06 SECSTATE 178303

¶A. Openness to Foreign Investment

Venezuela officially encourages foreign investment and provides equal treatment to local and foreign companies, though the actual environment is in fact considerably less welcoming. On January 10 of 2007, President Chavez announced that the government would nationalize companies in the electricity, telecommunications and petroleum sectors as well as re-write the country's commercial code. As of this writing, it seems likely that firms and shareholders will be compensated to some degree for their expropriated assets. Capital repatriation is allowed (subject to exchange control restrictions described below) and there are few formal restrictions on investments except for several sectors that are reserved to the State or Venezuelan nationals such as oil production, and power generation (with some exceptions).

The Venezuelan economy grew by 9.4 percent in 2005 and 10.3 percent in 2006, driven largely by a huge increase in government expenditures as a result of the continued oil bonanza. The official inflation rate reached 17 percent during 2006 due to higher consumer demand and excess money supply and many in the private sector argue that actual inflation is higher, still.

Statements by President Hugo Chavez and other Venezuelan officials about the need to adopt a new non-capitalist economic model (what Chavez calls "Socialism of the 21st Century"), an aggressive adoption of urban and rural "land reform" at the state and national levels, the takeover of "idle" industrial plants, the passage of legislation which has expanded the Supreme Court, with the subsequent appointment of judges on what observers consider a political basis rather than merit, and sudden unilateral increase by the Government of Venezuela in petroleum royalty rates for strategic associations have been negative developments.

On January 10, 2007, President Chavez announced that Venezuela would "nationalize" previously privatized companies and take control of as yet undefined "strategic sectors," including telecommunications and electricity. In general, the Venezuelan government has sought to promote an increasing state presence in areas of the economy previously left to private enterprise. The most prominent is its "Mercal" chain

of food stores aimed at low income Venezuelans, which is supplied by state purchases of commodities. Estimates are that approximately 47 percent of the sale and distribution of basic food products were sold through the Mercal program, benefiting over 15 million Venezuelans in 2006. Other areas that the Venezuelan state is reentering include civil aviation, telecommunications, cement production, paper manufacturing, and sugar refining.

In early 2003, President Chavez created an Exchange Administration Board (CADIVI) to regulate the purchase and sale of foreign currency and limit capital flight. The Central Bank liquidates CADIVI-approved requests for exchange. Initially, CADIVI was unable to process foreign currency requests efficiently and the Venezuelan Central Bank was only supplying currency to about 15-20 percent of approved authorizations. Over time, the system has improved, and in 2006 CADIVI authorized a total of USD $27.4 billion. Of this amount, 61.4 percent was for imports, followed by repatriation of capital (6.1 percent), private debt service (4.9 percent), and travel services through credit cards (4.5 percent). CADIVI also authorized to make payments through the Latin American Association for the Integration (ALADI) for USD 5.3 billion. CADIVI is currently also accepting currency requests in Euros. While CADIVI appears to more efficiently process requests for capital and consumer imports, it is less efficient processing requests for repatriation of profits, royalty payments, and payments for services. A number of goods were removed from the list of imports eligible for foreign exchange in 2006 in an effort to reduce imports and promote import substitution. A recent decree allows for the import of capital equipment, parts, and accessories free of duties and value added tax.

A Foreign Exchange Crime Law, published in the Venezuelan

Official Gazette No. 38,272 on September 14, 2005, established criminal penalties and fines for transactions made outside the official foreign exchange process, reinforcing the foreign exchange control regime.

Foreign Direct Investment (FDI) has declined precipitously in Venezuela from USD 3 billion in 2005 to only USD 75 million as of the third quarter of 2006. There are a number of projects under development or in pre-engineering stages, mainly in oil and gas or large infrastructure projects, though the proposed "nationalization" of energy sectors may stifle further development. The type of contractual relationship an oil company has with the state oil corporation PDVSA varies widely, depending on the nature of the underlying project. As regards to the latter, the preferred venture scheme has become sovereign deals or contracts between state corporations. Power, several road and railroad projects and the expansion of some production facilities for basic industry seem to be the main areas where there are projects in the pipeline. However, most of these projects have very little if any private participation at all.

As a member of the Andean Community, Venezuela accepted the application of the Andean Decisions, although examples can be found of non-compliance. In May 2006, President Chavez announced that Venezuela would leave the Andean Community and join MERCOSUR. The terms of accession to MERCOSUR have yet to be fully negotiated. Most Andean Community norms and obligations have remained in place, pending their replacement by new local laws.

A.a. The 1999 Constitution

The Venezuelan Constitution of 1999 treats private capital investment as a means of promoting the development of the national economy. Chavez has announced that the Constitution will be revised in 2007 and may include sweeping changes to

current laws governing private enterprise. Article No. 299 of the current Constitution recognizes private enterprise as a factor for creating sources of employment and local added value, as well as raising the standard of living of the population, within a framework of free competition. The Constitution reserves certain strategic sectors for the State, such as oil activity and hydropower generation.

Article 301 of the Constitution adopts international standards for the treatment of private capital, with equal treatment of local and foreign capital.

A.b. Legal Framework: Decree 2095

Decree 2095 (1992) establishes the legal framework for foreign investment in Venezuela. This Decree implemented Andean Pact Decisions 291 and 292 and significantly expanded foreign investment opportunities in Venezuela by lifting most restrictions on foreign participation in the economy. Most sectors of Venezuela's economy, except those specifically noted, are open to foreign participation. Article 13 of the Decree explicitly guarantees that foreign investors will have the same rights and obligations as national investors "except as provided for in special laws and limitations contained in this Decree."

Under Decree 2095, foreign investors need only register with the Superintendent of Foreign Investment (SIEX) within 60 days of the date a new investment is made. (The exception to this general rule is the Security and Defense Law, which provides that foreigners cannot own property in certain border regions or near military installations and basic industries without written authorization of the President through the Ministry of Defense.) Foreign companies may generally open offices in Venezuela without prior authorization from SIEX as long as they do not engage in certain sales or business activities that would require registration. No prior authorization is required for technical assistance, transfer of technology, or trademark-use agreements, provided they are not contrary to existing legal provisions. Shares of foreign companies may be sold publicly.

Decree 2095 also guarantees foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of the company, and allows for unrestricted reinvestment of profits. Foreign exchange is, however, still subject to government exchange controls.

Joint ventures and wholly owned subsidiaries of foreign companies are treated in the same way as Venezuelan firms. Only registration of the venture with SIEX is required. Decree 2095 imposes no limits on the amount of dividends, reinvestment, or repatriation. (The foreign exchange regime, however, has significantly affected such transfers.)

A.c. Limitations under Decree 2095

Decree 2095 reserves three areas of economic activity to "national companies": television, newspapers, and professional services that are regulated by national laws. A "national company" (as defined in Article 1 of Andean Pact Decision 291) is a company in which Venezuelan nationals hold more than 80 percent of the equity. Foreign capital is therefore restricted to a maximum of 19.9 percent in enterprises engaged in radio, television, Spanish-language newspapers, and professional services subject to licensing legislation (e.g., law, architecture, engineering, medicine, veterinary medicine, dentistry, economics, public accounting,

psychology, pharmacy, and management). Foreign professionals are free to work in Venezuela without restriction, but must first revalidate their title at a Venezuelan university. This is not required for consulting services under contract for a specific project. The Investment Promotion and Protection Law of October 1999 maintained these exceptions and reserved sectors.

A.d. Areas Covered by Special Laws

Sectors that are regulated by "special laws" that supplement the Constitution include hydrocarbons, natural gas, power, iron ore, mining, telecommunications, broadcasting, banking, mortgages, and insurance.

A.e. Hydrocarbons

VenezuelaQ,s vast reserves make oil and gas its leading sector for attracting foreign investment. However, foreign investment is restricted in the petroleum sector and may be restricted in the gas sector, depending on the outcome of proposed changes to the Constitution. The 2001 Hydrocarbons Law reserves exploration and production, as well as the "gathering" and initial transportation and storage of hydrocarbons to the state. Under this regime, primary activities must be carried out directly by the state, by a 100 percent state-owned company such as Petroleos de Venezuela (PDVSA), or by a joint venture company with more than 50 percent of the shares held by the state. The 2001 law does, however, leave new refining ventures open to private investment as well as commercialization activities, under a license and permit regime.

The Hydrocarbons Law mandated an increase in royalty payments from 16.67 percent to 30 percent, with the possibility of a reduction to 20 percent for heavy crude projects. It also stipulated that any arbitration proceedings would henceforth be in domestic not international venues.

Over the last two years the national government has made a number of changes in royalty, tax policies and contracts (aimed at increasing Government of Venezuela revenues and control of the sector) that have substantially increased uncertainty for companies operating in Venezuela. The Hydrocarbons Law did not specifically grandfather contracts executed under earlier legislation: i.e., the 33 operating service contracts awarded for "marginal" or inactive oilfields in three rounds in the 1990's; the exploration and production profit-sharing agreements awarded in 1996; and the

four so-called "Strategic Associations," joint ventures formed in the 1990's to extract and upgrade Venezuela's extra heavy oil. The Venezuelan Government argued in 2001 that no such provision was necessary because retroactive application of legislative provisions is forbidden by constitutional mandate. In October 2004, the Government unilaterally eliminated a nine-year royalty holiday ceded to the Strategic Associations, arguing that this was allowable under earlier hydrocarbons legislation. The government has announced that it wishes to convert the Strategic Associations to joint ventures under PDVSA control. It is currently in negotiations with the member companies to that end.

The government informed companies with operating contracts in early 2005 that they must migrate the contracts to joint ventures that conform to the 2001 Hydrocarbons Law. The government threatened to seize fields operating under the services contracts on December 31, 2005 if oil companies did not sign transition agreements to migrate their contracts. Sixteen oil companies signed memorandum of understanding

converting their contracts to joint ventures on March 31. Two companies, ENI and Total, did not sign a MOU and PDVSA took control of their fields.

The oil sector suffered two years of negative growth in 2002 and 2003 with a 14.2 percent reduction in real oil GDP in 2002 and 1.9 percent reduction in real oil GDP in 2003. The sharp decrease was due to a two-month national strike from December 2002-February 2003 that brought production to a complete halt. In response, the Chavez Government dismissed over 18,000 striking employees, many in management positions, of which only a small percentage have been rehired. Real oil GDP increased by 11.6 percent in 2004 and by 2.6 percent in ¶2005.

The Chavez administration has played a price hawk role to maintain high prices in OPEC. It has also begun promoting the regional development and integration of state energy companies under the name of "Petroamerica." Petroamerica has three components: Petrosur comprising the Southern Cone, Petrocaribe comprising the Caribbean nations, and Petroandina comprising the Andean nations. The stated purpose of the strategy is to diversify Venezuela's export market.

PDVSA's 2006-2012 Strategic Plan calls for the assessment and certification of the extra heavy crude oil reserves in the Orinoco oil tar belt (Faja). Memoranda of Understanding have been signed with various state-owned oil companies to certify 27 blocks with the participation of state oil companies from signatory countries. Investment under the strategic plan is supposed to reach USD $56 billion between 2005-2012, of which 70 percent will come from PDVSA and the rest from the private sector.

The GOV is repositioning itself as the main oil operator in country, cornering private investors, both domestic and foreign, and testing their willingness and capability to adapt to new conditions. The PDVSA business plan 2006-2012 seems to leave very little room for additional private investment in the oil sector, while favoring entrance of state-owned oil companies. The GOV is attempting to diversify its portfolio of oil clients and investors, and to be less dependent on the U.S.

A.f. Natural Gas

Venezuela has vast untapped natural gas reserves, estimated as the eighth largest in the world, and is promoting greater use of natural gas domestically as a clean and more cost-efficient energy source. Venezuela would like to take advantage of its reserves and geographic location to export natural gas to regional markets, including the United States. The 1999 Gaseous Hydrocarbons Law offers more liberal terms than are available to petroleum investors, and Venezuela's government has sought foreign investment to develop offshore natural gas deposits near the Orinoco delta.

The 1999 Gaseous Hydrocarbons Law opened the entire natural gas sector to private investment, both domestic and foreign. The law created a licensing system for exploration and

production of Venezuela's non-associated natural gas reserves regulated by the Ministry of Energy and Mines. Natural gas that is produced in association with crude oil production remains subject to the Hydrocarbons Law. The state retains ownership of all natural gas "in situ", but PDVSA involvement is not required for gas development projects. Complete vertical integration of the gas business from wellhead to consumer is prohibited.

In 2001, Venezuela held its first commercial auction of concessions for natural gas not associated with petroleum production and successfully awarded six of eleven onshore

areas it offered to bidders. In 2002 and 2004, the government licensed three exploration and development blocks in the "Deltana Platform," located in waters contiguous to Venezuela's boundary with Trinidad and Tobago. In 2005, Venezuela auctioned blocks within Rafael Urdaneta and Deltana Platform. Talks continue over the development of the Mariscal Sucre offshore natural gas project, which would involve the development of an LNG facility in Guiria in the Paria Peninsula. Venezuela also recently signed an agreement with Colombia that envisions the construction of a natural gas pipeline, which initially would bring Colombian gas to Venezuela but which could later be expanded to send Venezuelan gas to Central America. In November 2005, Venezuela signed an agreement with Argentina to study the feasibility of building a 6,000 km gas line. Finally, more private investor interest is anticipated for future gas rounds as Venezuela focuses on export oriented natural gas projects and promising off-shore exploration areas.

A.g. Electric Power

Electric power production requires intensive investments in all stages - generation, transmission, and distribution. In Venezuela, the area that is most in need of investment is generation, since approximately 70 percent of country's generation capacity is concentrated in hydro stations located in a single river basin. The 2000 to 2002 drought raised serious concerns and highlighted the need to increase and balance generation to mitigate the consequences of droughts and grid deficiencies. Investments in hydropower generation continue however, with the incorporation of Caruachi, a 2,280 MW dam, and plans to build Tocoma, which will supply an additional 2,160 MW to the system.

Although approximately 98 percent of the national territory receives electric service, transmission is an area that also requires intensive capital investments. Venezuela's transmission assets were developed between the 1960's and 80's. While maintenance has generally been adequate, population growth has outpaced upgrades creating transmission bottlenecks particularly in the central region of the country.

A legal framework has also been crafted to regulate the sector. Its implementation, however, has been stalled mainly over concerns about the ability of CADAFE (the national power utility) to un-bundle activities and honor contracts. CADAFE is involved in generation, transmission, and distribution of electricity and is often accused of having serious management issues and very high non-technical (commercial) losses.

The Government has an aggressive plan to supplement hydroelectricity generation with thermal generation units, many of U.S. origin. As a result, turbines now rank fifth among the leading U.S. exports to Venezuela this year. The Venezuelan Government has also announced its intention to revamp the national electricity grid with new high-voltage transmission lines.

A.h. Mining

The mining law of 1999 consolidates the provisions of the 1945 mining law with subsequent mining decrees and encourages greater private sector participation in mining activities. The mining law created the National Institute for Geology and Mining (INGEOMIN), which serves as a national information center to gather and disseminate technical and scientific data for the mining industry. The law established an

inter-ministerial commission to coordinate the mining sector's development between the Ministries of Energy and Mines (now the Ministry of Heavy Industry and Mining),

Environment, Defense, Finance, and Planning. It also called for "one-stop shopping" to be created within that commission to expedite concession authorization procedures.

The 1999 law maintained the basic concession terms of the 1945 law. Venezuela's concessions remain mineral-specific, and have a maximum 20-year authorization, which can be extended for an additional 20 years. The law lengthened slightly the exploration period from 3 years to 4 years, and the development period from 4 to 7 years.

The mining law also changed the mining sector's tax structure. The 1945 mining law required a small one-time exploration tax: a surface tax of 40 centavos per hectare for alluvial deposits and one Bolivar per hectare on veins and strata deposits and a layered royalty rate. The surface tax could not be adjusted for inflation because a fixed amount was written into the 1945 law and over time has become negligible.

The legalization of small and medium size mining operations has been viewed as a positive step toward the modernization of the sector and as a way to enforce environmental standards often violated by illegal small miners. The law, nevertheless, has been criticized for its high and variable royalties. A critical issue is a provision of Title VII that allows an exploitation tax of anywhere between 1 percent and 3 percent.

Individual mining firms have faced significant problems, and government officials have made comments that a generalized review of existing mining contracts may take place.

A.i. Telecommunications

President Chavez signed the Organic Telecommunications Law in 2000, replacing the antiquated 1940s-era law and setting the stage for significant levels of new investment in the sector. The new law, coupled with a national telecommunications plan developed by the National Telecommunications Commission (CONATEL) and the November 2000 expiration of the monopoly held by CANTV on basic telephone services, created a favorable climate for telecommunications investors. However, in January 2007, President Chavez announced that Venezuela would "nationalize" CANTV, which has cooled the climate for investment in Venezuela.

Venezuela received USD $771 million in investments in the telecommunications sector in 2005 and investment continued at a similar pace in 2006.

Venezuela has one of the leading wireless telephony markets in the region. Three major companies share the market: Movilnet (41.6 percent), Movistar (44.7 percent), and Digitel (12.1 percent). Movilnet is owned by CANTV, Movistar is owned by the Spanish Group, Telef"nica, and Digitel is owned by TIM, an Italian company.

EDELCA, a national utility involved in power generation and transmission and subsidiary of state-owned industrial giant, Corporacion Venezolana de Guayana (CVG), has formed a telecommunications company, CVG Telecom, using its existing fiber-optic capabilities and rights of access. According to the government, EDELCA's fiber optic capacity covers approximately 70 percent of its grid and is interconnected to grids in Colombia and Brazil. CONATEL, the Venezuelan regulatory authority, has given approval to CVG Telecom to provide telecommunication services directly to customers and CVG Telecom is already doing so in the Southern region of the country.

A.j. Banking

A 1994 Banking Law (Gazette No. 4641 of 1993) opened

Venezuela's banking and financial services sectors to 100 percent foreign ownership. Foreign banks may enter the

Venezuelan market in one of three ways: acquisition of shares of existing commercial banks or other financial institutions; creation of a new bank or other financial institution wholly-owned by foreign banks or investors; establishment of a branch of a foreign bank or financial institution. In 2001, President Chavez passed a new Banking Law as part of the package of enabling laws. This law regulates all banks with the exception of four state-owned banks.

Another important development for the banking industry is the Venezuelan government's new Treasury Bank created to centralize public sector resources, largely held in private financial institutions. The Treasury Bank was created by the Venezuelan government as a universal bank (one that is not limited in the types of services and products that it can offer) to act as the financial agent for the government, to pay the debt service (domestic and external debt), conduct foreign trade operations, receive income taxes, and serve as the government's cashier.

Applications for entry into the banking sector are submitted to the Bank Superintendency, which must seek an opinion from the Central Bank before granting authorization. The government can take into account "economic and financial conditions, general and local" (Article 11 of the Banking Law) and insist on reciprocity (Article 106 of the Banking Law) when deciding on an application for entry, but it has generally not used those powers.

Total bank assets increased from USD $40.1 billion at the end of 2005 to USD $63.5 billion in October 2006. Since late 1996, twenty banks have received authorization to become universal banks. Citibank and Stanford Bank are the only U.S. banks with operating branches in Venezuela. Citibank is the fifteenth largest bank with around USD $1,123 million in assets and Stanford Bank is the thirty-first largest with USD 214 million in assets.

In 2001 a Merger Law was passed, aimed at strengthening the financial sector by allowing stronger banks to acquire weaker institutions. Since the law was passed, 14 mergers have occurred reducing the number of small banks by twenty. By November 2006, the Venezuelan financial system consisted of 22 universal banks; 14 commercial banks; 3 development banks, 4 investment banks; 2 mortgage banks; 1 leasing company; 3 savings and loan associations; 2 money market funds; 4 special law-regulated banks. Of the 55 financial institutions, 45 are private and 10 are owned by the state.

The banking system is increasingly required to direct credit to borrowers in accordance with government requirements such as the imposition of a minimum amount of lending to be made to housing (10 percent), agriculture (16 percent), micro-business (3 percent), and tourism (2.5 percent). The Venezuelan Central Bank started to apply interest rate regulations at the end of April 2005, by which a maximum and a minimum levels were set for the banking system lending and deposit interest rates.

A.k. Insurance

Venezuela's insurance and reinsurance sector was opened to 100 percent foreign ownership in 1994. A subsequent decree passed on November 2001 (Official Gazette No. 5.553) establishes rules for contracts as the basis for insurance activity, detailing rights and obligations to guarantee equilibrium and protect customers. Foreign investors may acquire shares of an existing insurance or reinsurance company or create an entirely new company. Applications for entry into the sector are submitted to the Insurance

Superintendency for authorization. Foreign insurance companies are prohibited from offering insurance contracts fulfilled outside of Venezuela, unless the premiums become part of the net worth of an insurance company operating within Venezuela.

A.1. Privatization

The GOV has a Privatization Law (Gazette No. 5199 of 1997),

which allows for the privatization of public assets. A number of assets were bundled and earmarked for privatization in the early and mid 90s. From 1990-1998 FIV, the Investment Fund of Venezuela, the entity in charge of selling the assets and later renamed the Economic and Social Development Bank (BANDES), privatized over 40 entities and generated cash receipts of nearly USD $4.8 billion. Foreign investors purchased stakes in the telecommunications, electricity, steel, sugar refining, tourism, dairy, cement, and aviation sectors. However, President Chavez announced in early January of 2007 that he plans to undo a number of the privatizations, singling out the electricity sector and the national telecommunications company (CANTV).

The Chavez Administration has shifted its policy away from selling a large portfolio of assets toward forming strategic alliances, particularly in the form of contracts with state-owned enterprises of other countries. Participation in strategic associations regarding state owned entities is coordinated and administered by BANDES. The Government of Venezuela has created new state enterprises in aviation and telecommunicationQ*areas from which the state had previously exited.

A.2. Conversion and Transfer Policies

Foreign investors in capital markets and foreign direct investment projects are guaranteed the right to repatriate dividends and capital under the Constitution. However, the Law Governing the Foreign Exchange System (Gazette No. 4897 of 1995) permits the executive branch to intervene in the foreign exchange market "when national interests so dictate." After a steep decline in the value of the national currency (the Bolivar) following a two-month general strike that brought oil production to a near standstill, the Central Bank of Venezuela halted trade in Bolivars on January 22, 2003. President Chavez announced the creation of an Exchange Administration Board (CADIVI) on February 5, 2003 to regulate the purchase and sale of foreign currency. During much of 2003, CADIVI was unable to process requests for authorization of foreign exchange in an efficient and timely manner and only supplied USD $3.6 billion or approximately two monthsQ, worth of transactions. There has been significant improvement over time. In 2006 CADIVI authorized a total of USD $27.4 billion in foreign exchange requests and the Venezuelan Central Bank liquidated USD $26.1 billion. CADIVI is currently also accepting currency requests in Euros.

Decree 2095 guarantees foreign investors the right to repatriate 100 percent of profits and capital, including proceeds from the sale of shares or liquidation of the company, and allows for unrestricted reinvestment of profits. Problems with coordinating the timing of access to dollars, approval of import permits and licenses, and contracting the shipments have led to numerous delays and cancelled shipments.

A new Foreign Exchange Crime Law was published in the Venezuelan Official Gazette No. 38,272 on September 14, 2005, which establishes criminal penalties and fines for transactions made outside the office foreign exchange

process, reinforcing the foreign exchange control regime. Exchange control authorities have repeatedly said that the exchange control system will be eased but will remain in place permanently. The 2007 national budget recently passed by the National Assembly does not anticipate any currency devaluations from the current parity of 2,150 Bolivars per USD $1. Nonetheless, some local economists expect devaluation in 2007 due to the increasing disparity between official and parallel market rates. As of January 2007, the official rate was 95 percent overvalued as compared to the parallel rate.

A.3. Expropriation and Compensation

There have been several cases, which raise significant issues of expropriation and/or serious impairment of the value of foreign investments in the Venezuelan state. One case relates to INTESA, a joint venture formed between Science

Applications International Corporation (SAIC), a U.S. company, and VenezuelaQ,s national oil corporation PDVSA, to provide information technology services to PDVSA. PDVSA provided INTESA with a five-year service contract that it decided not to renew in 2002. INTESA continued to provide services under a provisional agreement while the parties discussed termination of the joint venture. The national strike then intervened in December 2002. The national government took over INTESA, claiming the firm had not allowed non-striking PDVSA personnel to restart operations by denying access to key control systems. SAIC's interest had been insured by the Overseas Private Investment Corporation (OPIC) which determined in July 2004 that an expropriation had occurred. It paid compensation to SAIC and has in turn sought repayment from PDVSA.

President Chavez, the National Land Institute, and state governments have ordered land seized without regard for due process. In April of 2005, the Venezuelan National Assembly revised Venezuela's 2001 land law. The revision reinstated an article in the 2001 law that allowed the takeover of land without court approval, a provision the Supreme Court had declared unconstitutional in 2002. The revised law calls for the redistribution of "unproductive" land, although it fails to establish productivity standards. The Venezuelan Government calls many of its seizures "rescues" of federal property rather than "expropriations," thereby justifying its non-payment of compensation. The government has installed state-sponsored cooperatives on properties under dispute and even on properties whose owners have won court decisions.

A 1998 land census found that 60 percent of all Venezuelan farmland was owned by less than 1 percent of the population. The census also noted that over 80 percent of the farmland redistributed during a 1960 land reform had returned to large landowners.

The Venezuelan government stepped up its campaign to expropriate land during 2006 in both urban and rural areas. In addition to the highly-publicized attempt to expropriate the Valle Arriba and Country Club golf courses in Caracas (currently being challenged in the courts), hundreds of "idle" homes and buildings in Venezuela are in various stages of expropriation. In addition, hundreds more are being occupied by illegal squatters with little government interference. Many rural land owners report invasions by government sanctioned groups and government resolution of these disputes is spotty, at best. State governments have also been known to expropriate idle manufacturing and processing plants to setup worker cooperatives, though in most cases companies have been able to settle with the government and obtain some compensation.

A.4. Dispute Settlement

Venezuela's legal system is accessible to foreign entities seeking to resolve investment disputes. While the legal system is often slow, inefficient, and has been accused of corruption openly politicized, foreign entities have not generally been discriminated against in legal proceedings. While not common, Venezuelan law allows the filing of criminal charges in some commercial disputes.

Decree 2095 allows for the arbitration of disputes as "provided by domestic law." The Commercial Arbitration Law (Gazette No. 36,430 of 1998) eliminated the previous requirement for judicial approval of arbitration. Arbitration agreements involving national or international firms can be automatically binding.

The Commercial Arbitration Law also allows state enterprises to subject themselves to arbitration in contracts with private commercial entities, but requires that they first obtain the approval of the "competent statutory body," as well as the "written authorization" of the responsible minister. In the case of PDVSA, for example, the Ministry of Energy and Mines issued a blanket written authorization in 1998, which allows the company to enter into such arbitration agreements, as it deems convenient or necessary. However, the 2001 Hydrocarbons Law prohibits PDVSA from entering into agreements providing for international arbitration.

A.5. Performance Requirements and Incentives

In any enterprise with more than 10 workers, foreign employees are restricted to 10 percent of the work force and Venezuelan law limits foreign employee salaries to 20 percent of the payroll. The state oil company, PDVSA, seeks to maximize local content and hiring in its negotiations with foreign investors.

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A.6. Right to Private Ownership and Establishment
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There are no legal limits on foreign ownership, except as noted in Decree 2095 and in "special laws" (see above).

CONTINUED IN SEPTEL: VENEZUELA -- INVESTMENT CLIMATE STATEMENT (PART 2/2).

BROWNFIELD